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In the Supreme Court of the United States

OCTOBER TERM, 1939

**GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, PETITIONER**

v.

MEREDITH WOOD

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT**

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(I)

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The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above entitled cause on June 16, 1939, affirming the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 22-29) is reported in 37 B. T. A. 1065. The opinion of the Circuit Court of Appeals is reported in 104 F. (2d) 1013.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 16, 1939. (R. 60.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer in 1931 declared himself trustee of certain property for a period of three years (later extended to five years from the original date) or until death of either himself or his wife within that period. During the continuance of the trust, the net income was to be paid to the taxpayer's wife and upon termination the corpus was to remain his or to be transferred to his estate. Is he taxable upon the trust income thus paid to his wife in 1934?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are printed in the Appendix, *infra*, pp. 7-13.

STATEMENT

The material facts as stipulated (R. 40-56) and found by the Board of Tax Appeals (R. 22-25) are as follows:

The taxpayer resides at Scarsdale, New York. (R. 22.) On April 8, 1931, he executed a declaration of trust in which he, as the owner of 25 shares

of the capital stock of Book of the Month Club, Inc., declared himself trustee, "to hold the same In Trust, to hold, invest and reinvest the same, to collect the net income therefrom from the date hereof and to pay the said net income, as and when received by him, to his wife, Helen Martin Wood, until the termination of this trust." (R. 23.)

The declaration of trust provided, *inter alia*, that the trust should continue in effect until (a) the expiration of three years from the date of the instrument, or (b) the death of the settlor, or (c) the death of Helen Martin Wood, whichever event should first happen. Upon termination the property was to be transferred to the settlor to be his own, except that in case of termination of the trust by his death the property would go to his executors to be disposed of as part of his estate. A supplementary declaration of trust, executed on March 25, 1932, extended the three-year period for the continuance of the trust to a five-year period from April 8, 1931. (R. 23.)

The declarations of trust provided that the settlor might "determine whether any property or money received or held in trust shall be treated as capital or income, and the mode in which any expense incidental to the execution of the trust is to be borne as between capital and income." (R. 23-24.)

Although there were provisions for a substitute trustee and power to dispose of the corpus under

specified conditions (R. 23-24), the taxpayer at all times after the creation of the trust and until April 8, 1936, continued as trustee to hold the stock as the sole corpus. (R. 24.)

After April 8, 1931, and during the year 1934, all dividends paid on the stock were received by taxpayer as trustee, deposited by him in a special bank account, and paid over to his wife. (R. 24-25.)

The taxpayer duly filed his income tax return for the year 1934 and paid the tax shown to be due thereon, failing, however, to include the trust income, which amounted to \$8,750. The Commissioner increased the taxpayer's income for 1934 by that amount. (R. 25.) Upon review, the Board of Tax Appeals held that such action of the Commissioner was erroneous and the court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In failing to hold that the trust income here involved is taxable under Section 166 of the Revenue Act of 1934.

(2) In failing to hold that Article 166-1 of Treasury Regulations 86 constitutes a valid construction of the Revenue Act of 1934 as applied to the facts of this case.

(3) In failing to hold that the income involved is taxable to respondent under Section 22 (a) of the Revenue Act of 1934.

(4) In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The issues here presented are likewise involved in *Helvering v. Clifford*, in which a petition for a writ of certiorari is being filed herewith. Reference is here made to the petition in that case for the reasons which call for review of these issues.

In certain particulars, the instant case presents facts that even more strikingly call for the application of Section 166 of the Revenue Act of 1934 and Article 166-1 of Regulations 86, promulgated thereunder. The *Clifford* case involves a five-year trust created during the tax year. Here, the trust was established in 1931 to last for three years, and amended in 1932 to last for five years from the original date. It was thus never substantially more than a four-year trust, and, at the end of the tax year 1934, it was less than a sixteen-month trust. Moreover, the taxpayer undertook to reserve the right to determine whether any property or money received by the trust should be treated as capital or income (R. 23-24), thus retaining the power to distribute income to his wife or to retain it for himself.

CONCLUSION

It is therefore respectfully submitted that this petition for a writ of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

SEPTEMBER 1939.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) General Definition.—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (c), relating to the so-called "charitable contribution" deduction); then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question." (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 166-1 [as amended by T. D. 4629, XV-1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937-2 Cum. Bull. 117, 118].
Trusts, with respect to the corpus of which,

the grantor is regarded as remaining in substance the owner.—(a) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to re-take the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession

and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to re-vest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those

which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(c) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the ab-

sence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(d). If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof

realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to re-vest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.